

Regulation and Supervision of Microfinance in Egypt

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In 1996, Moussa joined Environmental Quality International (EQI) as senior manager and finance advisor. He also served the Near East Foundation (NEF) as the finance services manager for the Eastern Mediterranean Region. He played leading key management/financial roles on a number of donor-funded and private sector-led projects in Egypt, Africa, and the Middle East. Currently, Moussa is working with PlaNet Finance as a Senior Microfinance Advisor for the Middle East and North Africa Region (MENA). Moussa has gained specific experience in designing and managing microfinance programs – including bank down-scaling - in the Middle East, the Gulf region, and the horn of Africa. In addition to MFI capacity building, Moussa has materially contributed to the development of a national framework for the Microfinance industry in Egypt, Sudan, and on a regional scale in Syria.

In a voluntary capacity, Moussa is currently a board member of the Egyptian Women Health Improvement Association (WHIA) – Tadamun MFI, a member of the Egyptian Tax Association, and a member of the Egyptian Society for Political Economics, Statistics, and Legislation. Moussa has prepared a study on Performance Standards and Non-prudential Regulation, which is posted on the Arabic Microfinance Gateway.

ABOUT THE SERIES

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INTRODUCTION

THIS ESSAY PROVIDES a practitioner's overview of Regulation and Supervision as they relate to the Microfinance (MF) industry in Egypt. In order to cover this discussion in an ample manner, the reader should be familiarized with the range of services offered (or to be offered), as well as the institutional setup of the service providers. This is because some MF services - like capturing savings, remittances, leasing, etc. - require specific regulations and/or supervision to either provide the service or continue in operation. Moreover, the institutional setup of the MF service provider will have a direct effect on the modality and frequency of supervision that it receives, as well as determining the designated supervisory body. An important benchmark for the MF industry in Egypt was created with the launching of the Egypt MF Strategy,¹ which tackles the issue of regulation and supervision (among others). To that end, this essay draws on the substance of the national Strategy, which has been endorsed by the Social Fund for Development (SFD).²

As such, the essay is divided into three sections:

The first section shall introduce the reader to the range of MF services offered, the institutional setup of the various service providers, and a brief on the Egypt MF Strategy as it relates to regulation and supervision.

The second section of the essay outlines relevant laws and regulations concerned with the MF sector and service providers. It shall also provide a brief description of the entities entrusted with the role of supervision and the practical application thereto. Finally, the second section shall end with a discussion of the impediments to sector development/service outreach that result from either legal aspects or supervision practices.

The third and last section shall highlight current activities underway to overcome the impediments and expand service coverage, with future recommendations, based on the author's experience as a practitioner.

Microfinance (MF) Services Offered

In general, credit has been the main type of microfinance product offered to the Egyptian market. Credit is offered in the form of micro-loans that are predominantly provided through non-governmental organizations (NGOs). In addition to credit, other financial services such as savings, other deposits, and insurance are available on a small scale and are restricted to formal financial institutions. The following paragraphs provide a brief description of the services mentioned above:

1. A project jointly funded by USAID, KfW, and UNCDF. See <http://www.undp.org.eg/news/press/2005%20press/microfinance%20strategy.htm>. The author has played a substantial role in the development of the Strategy and its associated action plan.

2. As discussed below, the SFD is a quasi-governmental entity that is responsible for the government's planning and coordination functions regarding the microfinance sector.

Credit Services

Credit services provided in Egypt are dominated by two types of products: individual loans that provide working capital for existing enterprises (operating for at least one year), predominantly in the retail and mercantile sectors in urban and semi-urban settings; and group lending for income-generating activities of women, especially female heads of household in the lowest income categories. Some microcredit programs provide uncollateralized agricultural credit, but these programs have been small in scope and have not always followed best practices. Other types of credit services, including asset-based lending and micro-leasing products, have not been provided on a significant scale in Egypt.

Savings/Deposit Services

Although public- and private-sector banks offer savings accounts to the general public, the National Postal Authority remains the dominant provider of micro-savings due to its extensive outreach and low-cost application procedures. (Neither non-bank financial institutions nor NGOs are allowed to capture savings.) However, low-income savings mechanisms are often informal due to the reluctance of entrepreneurs to deal with the banking system (which can be rather intimidating) as well as the banking sector's unwillingness to deal with small savings due to the higher associated administrative costs.³ Consequently, large amounts of savings remain non-utilized for financial intermediation.

3. Opening a savings account costs banks EGP 19 (approx. USD 3) in stamp duties, which according to bank complaints would not be worthwhile in the case of low savings balances.

Insurance Services

State-owned companies continue to be the main providers of insurance services to this sector – namely, Misr Insurance, Al Chark Insurance and Al-Ahli Insurance, which together with the private-sector Egyptian Reinsurance Co. account for 90% of market share. While some of their products are affordable for micro-enterprises and micro-consumers, the state-owned companies follow supply-driven approaches – the products are neither designed nor marketed to meet the needs of the micro sector. Some microfinance programs, like the National Bank for Development (NBD), provide life insurance to their clients to cover part of the amount lent in case of default due to death. However, these insurance packages are only provided embedded with credit packages to reduce MFIs' risk of default, not offered as a stand-alone product.

The Institutional Setup of Microfinance Institutions (MFIs) and Other Relevant Stakeholders

As described above, microfinance services provided in Egypt are mostly limited to credit and – to a lesser extent – savings products. Micro lending in Egypt is provided through two main channels. The first is through public and private banks, which are regulated by the Central Bank of Egypt (CBE) and operate under the new banking law, [Law No. 88 of 2003](#). The second is through NGOs, which are regulated by the Ministry of Social Solidarity (MSS) and are governed under [Law No. 84 of 2002 on](#)

Non-Governmental Societies and Organizations.

Savings/Deposits and insurance are provided by formal financial institutions (i.e. banks and licensed insurance companies, respectively). Other institutional stakeholders include the Social Fund for Development (SFD) and the nascent Egypt Microfinance Network (EMFN). The following paragraphs provide a brief introduction to the relevant service providers and stakeholders:

Public and Private Banks

While public-sector banks have recently begun to engage in microlending, private commercial banks are still absent from the sector, as they tend to regard microfinance either as too risky or as a developmental function that should be reserved for NGOs and public-sector banks. This perception results from the fact that most of Egypt's microfinance initiatives – namely, financing of working capital – have been donor-driven initiatives aiming to help existing micro-enterprises meet their short-term financial needs. Notably, the United States Agency for International Development (USAID) has initiated and funded most of the microfinance activities in Egypt, with estimates crediting USAID with financing more than 50% of all activities in the sector.⁴

There are only three banks in Egypt that are currently engaged in microlending programs. These consist of two state-owned banks – Banque du Caire/Banque Misr⁵ and the Agricultural Bank for Development and Credit (PBDAC) – and a single private bank, the National Bank for Development (NBD). Apart from PBDAC's programs, which provide loans to rural women and farmers, all banks offer financing of working capital (short-term assets) largely to trade- and service-oriented micro-enterprises and – to a lesser extent – manufacturing-oriented enterprises.

NGOs

Financial services to small and micro enterprises are also provided through lending programs by NGOs that are financed by national and international donor agencies. Activities of NGOs, including financial service activities, are governed by Egypt's [NGO Law 84 of 2002](#), which requires that they operate as not-for-profit associations, foundations, or unions. Credit is the dominant service provided by NGOs to micro enterprises.

The types of NGOs that are engaged in lending to small and micro enterprises can be distinguished as follows:

Specialized NGOs: These microfinance institutions (MFIs) are business associations that are usually governed by people with strong business backgrounds. USAID has supported the establishment or development of several business associations in different governorates that are the largest NGO lenders in Egypt in terms of lending volume. These USAID-supported MFIs normally maintain their loan capital as USD deposits in commercial banks, against which they are offered a credit facility in local currency. Recently, some USAID-supported MFIs entered into guarantee agreements with the Credit Guarantee

4. As of early 2003, estimates credited USAID with financing nearly 70% of all sector activity. See United Nations Capital Development Fund et al., *Microfinance Sector Development Approach (Egypt)* (March/April 2003), available at http://www.uncdf.org/english/countries/egypt/microfinance/UNCDF_Egypt_MF-Country%20Assessment.pdf.

5. Bank Misr recently acquired Banque du Caire.

Company (CGC), whereby the CGC guarantees the MFI portfolio for a pre-negotiated fee. With respect to outreach and sustainability, these specialized NGOs tend to be the most successful players.

Social Development NGOs: These NGOs, which are funded by the SFD and foreign donor agencies, have a broader mission and provide a range of community-based social development services, of which microcredit is but one. They typically have limited experience and expertise with – and at times low appreciation for – microcredit best practices. Their results in terms of outreach and sustainability are mixed.

Umbrella NGOs: These NGOs serve as a nationwide network of community-based organizations and are often closely linked to the government. They face issues similar to those of the social development NGOs.

Community Development Associations (CDAs): These small, local, voluntary organizations tend to perform a “credit retailer” function for umbrella or social development NGOs. Activities are largely performed by volunteers. Understanding and concern for microcredit best practices is very limited.

The National Postal Authority

The National Postal Authority is a significant player in the microfinance sector because it offers savings accounts with competitive interest rates and because it controls a formidable national network of facilities, thus reaching the grassroots of Egyptian society in both urban and rural areas. The Postal Authority has nearly 10,000 outlets (3,400 post offices and 6,000 postal agencies) throughout Egypt. Its workforce of 45,000 individuals serves 11 million Egyptians who maintain EGP 22.5 billion (approx. USD 4 billion) in postal savings accounts.

During recent efforts by the government to restructure and modernize the Postal Authority, new cash-transfer services have been introduced in collaboration with Western Union to diversify the product portfolio offered to customers. In addition, the Postal Authority recently signed a cooperation protocol with the Social Fund for Development to provide microcredit services to its clients. While details have not yet been finalized regarding the nature of services that would be offered, given the Authority’s extensive network of facilities, the outreach impact would very likely be profound.

The Social Fund for Development (SFD)

The Social Fund for Development is a quasi-governmental entity established in 1991. The SFD receives funding from the government and from donor agencies (largely the World Bank). Initially, SFD was regarded as a social safety net associated with the Government of Egypt’s agreement to undertake its extensive Economic Reform and Structural Adjustment Program. At such time, the SFD was considered an essential tool to the actual

success of the reform program, serving as a safety net for employees laid off due to privatization and as a catalyst for economic empowerment through promoting self-employment. Today, SFD has adopted a new development perspective to help alleviate poverty and combat unemployment. In this capacity, it creates employment opportunities for start-up entrepreneurs and provides them with credit, technical assistance, skills, and technological know-how (both Egyptian and international). In addition, the SFD, through its microenterprise department, acts as an umbrella organization that supports the creation and/or development of successful MFIs in cooperation with international donor agencies (chiefly the EU). Finally, the new [SME Law No. 141](#)⁶ names the SFD as the official entity responsible for the Planning and Coordination functions related to the MF sector, although MFIs are not obligated to report to the SFD as a result of this law. The objectives of the SFD are:

- Creating employment opportunities for new graduates, unemployed youth, and low-income groups through the encouragement of small enterprises (both newly-established and already-existing).
- Directing additional public investments toward services of a social, health, educational, and environmental nature.
- Establishing mechanisms to protect vulnerable population groups and improve their living standards (such as women, children, and the elderly).
- Engaging NGOs and PVOs in implementing projects that serve the target groups.
- Strengthening partnerships with the government and all major players in the decision-making process.
- Replicating the SFD model in different parts of the world.

Recently, the SFD participated as the Egyptian counterpart agency in the research project initiated by the United Nations Capital Development Fund (UNCDF), USAID, and the German Development Bank (KfW) to issue a national strategy for MF and an associated action plan. The project took almost two years, culminating with the official launch of the Strategy and endorsement by the SFD, donors, and major MF players in Egypt. The SFD is also supporting the initiative to establish the Egyptian MF Network, which is currently underway. SFD is providing mainly financial support (providing grants towards establishment), as well as advocacy and institutional support.

Egypt National Microfinance Network (EMFN)

The continuous growth of the MF industry has led many institutions with different legal forms to engage in the provision of financial services to microenterprises. In view of the increasing number of MFIs and the need to have a unified body to represent their common interests, the Egypt National Microfinance Strategy document strongly recommended the establishment of a local network to represent Egyptian MFIs' aspirations, assist in the compilation of market-related information, and provide other services to member and non-member MFIs. The SFD is endorsing this effort and participates

6. <http://www.sfdegypt.org/law.asp>. Highlights of the law are outlined in the following section.

as a Board member in the Network. The EMFN is newly registered and is in the process of finalizing its detailed business plan. Some of the identified objectives of the EMFN are to:

- Promote and facilitate information exchange among members.
- Promote adherence to best practice MF among member and non-member MFIs.
- Establish a relevant database on sector players and performance in an attempt to establish Egypt-specific benchmarks for the industry.
- Promote adherence to assessment and rating exercises for member MFIs.

Egypt's National Microfinance Strategy

“Building a National Strategy for Microfinance in Egypt: A Sector Development Approach” is a project that aims to develop a strategic framework for increasing the efficiency and effectiveness of concerted governmental, non-governmental, and donor efforts to promote the development of microfinance in Egypt. Implemented by the Central Bank of Egypt (CBE) (represented by the Egyptian Banking Institute), this project was co-funded by the United Nations Development Program (UNDP), USAID, and KfW. Managed by the UNDP with the technical support of the UNCDF, the project is advised by a steering committee comprised of representatives from these organizations. The SFD is also represented in the steering committee, in recognition of its active participation in the development of the Strategy and its role as the entity designated for national coordination of all SME-related activities, including the provision of financial and non-financial services.⁷

The project is based on a consultative process that brings stakeholders together to deliberate on the challenges and constraints facing the microfinance sector in Egypt, as well as to identify the priority actions needed to address these in a manner that reflects commitment to a market-oriented industry. The Strategy classified obstacles faced – and, accordingly, the required interventions – into three levels: Micro, Meso, and Macro. The Micro level refers to intervention at the level of the MFI (i.e. direct financial service providers); the Meso level refers to interventions at the level of institutions that serve financial service providers (apex and institutional support services); while the Macro level refers to policy- and law-related interventions that contribute to a more conducive environment for improving service quality, diversification, and outreach. The objectives of each level are as follows:

The Micro Level: To promote the development of a diverse range of sustainable MFIs that compete to offer various effective financial services to micro enterprises and the poor, and that cater to evolving market demand.

7. The German Agency for Technical Cooperation (GTZ) also provided the project with in-kind support, in the form of expert advice in the field of regulation. The Canadian International Development Agency (CIDA) provided advice to ensure that the Strategy was gender-sensitive.

The Meso Level: To support the sound functioning of existing apex institutions and national guarantee mechanisms.

The Macro Level: To develop a policy and regulatory environment conducive to an inclusive financial system that encourages the growth and development of microfinance.

Regulatory Environment and Supervision

Relevant Laws and Regulations

Law # 141 (2004)

The Small Enterprise Development Law No. 141 of the year 2004, also referred to as the SME Law, was promulgated in June 2004, and its Executive Regulations were issued by the Prime Minister in July 2004. The most important subject in the new Law that relates to regulation and supervision is defining the role of the Social Fund for Development (SFD) as the body responsible for coordinating between the relevant stakeholders.

The Law identifies the SFD as the body responsible for the development of enterprises subject to the Law. Specifically, the SFD is responsible for “planning, coordinating and promoting the spreading of SMEs and assisting them in obtaining financing and services” (Articles 2 and 4 of the Law). The issuance of the Law was accompanied by debates on the interpretation of this text and whether it will lead to the SFD’s becoming the exclusive body overseeing the affairs of SMEs. This debate is a result of an imprecise reading of the Law’s provisions.

On one hand, there is no doubt that the referenced text aims to create a national framework to coordinate the numerous entities – including governmental, nongovernmental, and commercial entities – that are involved in financing and developing SMEs. This reflects the situation in the recent years preceding the issuance of the law, in which instead of a single body responsible for monitoring and coordinating this sector, there were several bodies, each with its own perspective. In light of the fact that banks are now engaging in MF service provision – and in view of the Central Bank of Egypt’s requirement to report only on loans in excess of EGP 30,000 (approx. USD 5,200) – there is a real need for a monitoring body for the entire MF sector, including banks and NGOs.

However, a significant distinction must be drawn between authorizing a supervisory body and authorizing a coordinating and monitoring body. A supervisory body – as is the case with the Central Bank of Egypt or the Capital Market Authority – is

responsible not only for monitoring the activity in a specific sector but also for issuing working licenses to applicants and for inspecting their activities. A coordinating body, by contrast, does not enjoy the authority of supervision in the manner mentioned above, but rather is vested by law with the authority to monitor, coordinate, and plan – without interference in the work or affairs of those practicing the activity to be monitored.

The role of the SFD by virtue of the new law is not supervisory, so it will not have the authority to interfere in the activities of those institutions interested in providing financial or non-financial services to small and micro enterprises. Nor will the SFD become the registrar or licensing body for MFIs/SME lenders. To restate, the law designates the SFD as the single body responsible for “planning, coordinating and promoting the spreading of SMEs.”

The Executive Regulations indicate that the SFD’s role will be more than a mere official formal position. For instance, the SFD, with its new authority to plan and coordinate, should have the legal authority to obtain information and data concerning the activities of the different entities involved with SMEs⁸ (in particular, information regarding MFIs/SME lenders’ portfolio and financial performance). The SFD should be able to develop clear and binding mechanisms for obtaining information from these entities, either directly or through the proposed self-regulatory organization (SRO, see below) and the EMFN. It should further be knowledgeable of the resources and facilities allocated for this sector from the various financing and donor agencies, and it should coordinate between them so as to avoid controversies, duplications, and waste of resources. All of this can be carried out without the SFD’s becoming a regulator or licensor of the activity or interfering in the affairs of those practicing it.

8. Currently, commercial banks are not obligated to provide this information to the SFD.

Law # 84 (2002)

This law regulates the incorporation and operations of non-governmental organizations and foundations. This law affects MF, as many NGOs offer MF services in Egypt. The Law designates the Ministry of Social Solidarity (MSS) as the official governing body for NGOs. Under the Law, all NGOs are obliged to register with the MSS before providing services, and they must also submit copies of Board meeting minutes to the MSS. NGOs should also submit annual audited financial statements to the Ministry, and the Ministry has the right to inspect and audit the NGOs’ books and records. According to the law, NGOs are not allowed to earn profits, though they may achieve a surplus of earnings over expenses provided that this surplus is utilized for the original purposes of the NGO. NGOs cannot offer part of their assets as collateral, and they are not allowed to undertake activities that entail speculation. The NGO MFIs are allowed to offer loans to SMEs under the title of “activities to enhance the economic status of targeted community,” which is allowed under the law.

It should be noted that the Law was designed without taking into consideration the specific operational and financial nature of NGO MFIs; this is the major obstacle in terms of supervision, as outlined below.

Supervisory/Regulatory Entities and Application

Different authorities/entities are responsible for regulation and supervision of MFIs, depending upon the legal identity of the particular MFI. The Central Bank of Egypt (CBE) is the prudential regulator of banks, and the Ministry of Social Solidarity (MSS) is the regulator of NGO MFIs. As discussed above, the Social Fund for Development (SFD) is the coordinating and planning body for MFIs, as designated by the Law.

Another aspect that affects regulation and supervision is the type of financial services that an MFI wishes to offer. For example, MFIs wishing to capture savings and/or other deposits should be duly incorporated as a formal financial institution (a bank), while only an insurance company may offer life, accident, and disability insurance. These services are not, accordingly, allowed to be offered by NGOs.

In practice, the CBE performs a full range of supervisory functions over banks, including the initial licensing, performance monitoring, and requirements for maintaining legal reserves at the CBE and minimum cash reserves to meet clients' demands for withdrawals from savings, current, and other deposit accounts. As far as client credit history is concerned, the CBE maintains a unified database for banks' client credit history ("credit bureau") for clients taking individual loans with a principal balance of over EGP 30,000 (approx. USD 5,200).⁹ However, bank MFIs' clients have not hit this ceiling, and therefore banks do not supply credit information on these clients.

The MSS oversees NGO MFIs by conducting routine checks on their financial statements (limited to Income/Expense accounts) and requiring that an MSS representative be permitted to attend General Assembly meetings and extraordinary meetings of the Board of Directors, as well as to retain a copy of the minutes. The main problems with the MSS oversight originate from two facts: (i) the limitations of applying to MFIs a law that is intended for general application to all NGOs (and the consequences for MF best practices) and (ii) the MSS auditors' lack of professional training in MF. Specific problems arising from these limitations will be outlined in the following section.

Finally, the SFD has no regulatory authority by virtue of law. Its role, however, in supporting the EMFN and the proposed SRO will allow it to have a more hands-on role in practice, even if not stipulated by the law (as previously discussed).

9. USAID is also funding a project that aims to establish the first private-sector credit bureau in Egypt. As of the date of the essay, the CBE had already approved the application to establish the bureau (for now, only banks will have access). Operations are expected to commence during the second quarter of 2007. For more information, see http://www.usaideconomic.org/eg/EFS/task_results_details.asp?tasks_id=184&no=4.

Regulatory and Supervisory Impediments to MF Sector Development (for NGO MFIs)

Access to Funds

It is well-known that MF is a capital-intensive activity, as MFIs require sustained injections of capital for on-lending, especially when, as is currently the case, the demand for such services far exceeds supply. Restrictions imposed by the MSS, however, prohibit NGOs from capturing savings and impede the ability of NGO MFIs to borrow commercially (due both to bank regulations restricting banks' ability to make uncollateralized loans and the prohibition on NGOs pledging their assets). Meanwhile, credit guarantee facilities, which enable MFIs to leverage funds from banks, have only been offered to a handful of NGOs, primarily through the Credit Guarantee Company. (In addition, about three other NGO MFIs are accessing foreign guarantee facilities.) At the same time, due to the difficulty in meeting the reporting requirements of donor agencies,¹⁰ NGOs have not been able to access sufficient donor funds to cover existing demand for microfinance in areas where the NGOs are already operating, let alone the costs of expanding to new geographic areas.

10. Donor agencies require transparent performance reports and credible audited financial statements. In contrast, the MSS annual audits on NGOs concentrate on expense and revenue accounts; they do not take into consideration important MFI-specific issues like portfolio quality and adequate provisioning.

Check Endorsement by the Treasurer

Another major impediment to outreach is the legal requirement for NGOs to have all checks for loan disbursements signed by the chairman of the board (or a delegate thereof) and the treasurer. As NGOs continue to expand, the volume of transactions will increase significantly, and unless more appropriate procedures are instituted, delays in processing loans will become inordinate. To address this issue, the MFIs asked for a revision of the Executive Regulations of the NGO law to also give an MFI's Executive Director or the Microfinance Activity Manager authority to endorse checks in order to speed the process of loan disbursement.

MSS-Required Approval of Board of Directors' Decisions

A copy of the NGO MFIs' Board meeting minutes must be sent to the MSS for stamping. The Ministry sometimes disapproves of a decision taken by the Board, which may hinder (in some instances) the MFIs' compliance with international MF best practices. One example was the decision of one Board to charge penalties for late repayment. Although the purpose of this decision was to ensure clients' commitment to the payment schedule, some MSS directorates disapproved it.

MSS Auditing and Reporting Requirements

MFIs face certain challenges with respect to auditing and reporting requirements. The MFIs' nature – as providers of microcredit – requires a different accounting and financial system than that of the other types of NGOs. Yet, the MSS auditors ask for financial statements that reflect revenues versus expenses only. Moreover, the financial auditors do not approve reports extracted from computerized accounting systems, instead

requiring hand-written general ledgers. This is a major problem for NGO MFIs with sizeable portfolios, some of whom have as many as 50,000 active clients.

Interest-Rate Restrictions

While it has not been a significant problem in practice, the Civil Code prohibits lenders from charging above certain established interest rates.¹¹ Under the Law on the Central Bank, this restriction does not apply to banks; however, there is no law exempting NGO MFIs from the Civil Code provision. In certain cases, clients of NGO MFIs facing legal action for collection of unpaid loans have counterclaimed that the interest rates charged by the NGO MFIs violate the Civil Code.

11. Article 226 of the Civil Code limits interest rates to 4% for civil debts and 5% for commercial debts.

Towards a Regulatory Environment that is Conducive to MF Development

Current Activities and Developments

Currently, MF is gaining in importance as a tool to fight poverty and, accordingly, improve social stability. In response to the launch of the National MF Strategy in December 2005, the government and the donor community have decided to support the implementation of the Strategy's recommendations and action plan.

As of the date of this essay, the EMFN has been duly incorporated and is in the process of developing its business plan and securing start-up funding for its activities. The activities will mainly consist of advocacy, technical and information services for MFIs, and establishment of the self-regulatory organization (SRO).

Finally, notwithstanding the recently-established private-sector credit information agency, there is a perceived need among sector players to develop an MF-specific credit bureau. To that end, since banks are becoming increasingly involved in MF service provision, their participation in such a bureau would be required for it to be effective. Currently, the USAID-funded Egypt Microenterprise Finance project (EMF) is evaluating various options for offering this service to Egyptian MFIs and is providing technical assistance.

Future Recommendations

Recommendations that meet real MF sector needs and are supported by the Strategy include the following:

Encourage Adherence to Reporting Standards and Performance Benchmarks (potentially SRO)

The adoption and implementation of a clear and unified set of financial reporting standards and key performance benchmarks

among microfinance providers – particularly NGO MFIs – will enhance the transparency and professional standards of the industry, and ultimately, its legitimacy. It will enhance competition and increase capital providers' confidence in the industry in general (and in microfinance service providers in particular).

Establish Clear and Unified Criteria for Financing MFIs (potentially EMFN)

Apex institutions that provide capital to MFIs should establish standardized financing criteria that are based on microfinance best practices. To this end, close coordination with a self-regulatory mechanism (proposed to be established) and consensus on reporting standards and performance benchmarks would be essential. Establishing reporting standards and performance benchmarks is considered a prerequisite for establishing **clear, agreed-upon, unified, and objective** criteria to prioritize supply to MFIs of institutional capital, including requirements with respect to loan provisioning and asset acquisition. The criteria should be based on international best practices and should include consideration of the MFIs' productivity, profitability/cost coverage, portfolio quality, and asset utilization efficiency. Such criteria should also cover new MFI entrants to the market and compare their business plan targets to national and regional benchmarks. These criteria should provide the baseline requirements that MFIs must meet to be eligible for apex financing.

Institute the Use of International Rating Agencies (potentially SRO)

The adoption and use of rating facilities/services by MFIs attests to their professionalism and diligence. To that end, it is advisable for MFIs to resort to an internationally recognized assessment and rating facility (e.g. CGAP rating initiative), or to engage private-sector raters (nationally and internationally recognized). These raters would offer a well-designed and independent evaluation and rating service to microfinance institutions. This type of independent evaluation should be undertaken routinely by MFIs, with a reasonable frequency (every 2 to 3 years). This certification should form the basis for MSS, donor agencies, SFD, banks, and guarantee companies in determining the creditworthiness of MFIs (and consequently, their eligibility for financing).

Establish a Non-Prudential Self-Regulatory Mechanism

The establishment of an independent, member-driven and -supported self-regulatory organization (SRO) to enhance the development of the sector by implementing a set of non-prudential regulations and ensuring MFIs' self-enforcement for compliance with the specified performance standards is required. For institutions that confine their activities to credit and that are, by law, regulated by different governmental bodies, mechanisms of non-prudential regulation monitored by self-regulatory organizations (SROs) – of which the regulated

institutions are members and decision-makers – are the most suitable means to regulate certain operational aspects.

Such an organization would need a clear mandate, as well as technical and financial support from key industry stakeholders. The EMFN could effectively serve as a launching pad for such an organization. A non-prudential regulatory framework that recognizes the unique features of MFIs is required. Moreover, rapidly maturing microlending NGOs are in need of governance structures to maintain a commitment to the target group of microenterprise clients. This necessitates the following:

- Establishing reporting standards for MFIs (with proper distinction between different legal types, i.e. banks and NGOs).
- Establishing a mechanism to provide regular reporting to the SRO in a user-friendly, automated manner, as well as the frequency for such reporting.
- Establishing a mechanism to disseminate consolidated information on the sector and MFIs to member institutions, as a service in exchange for sustained commitment and submission of periodic reports.
- Recognizing the SRO on the part of various donor agencies (i.e. including reporting to the SRO as part of the funding criteria for MFIs) so as to provide it with greater legitimacy among MFIs and to encourage membership. This is considered the bottom line for the success and sustainability of the SRO, as MFIs will not be motivated to submit reports to the SRO unless they feel a material benefit from doing so.

Recognize Specialized Credit NGOs (Advocacy by EMFN)

Despite the success of NGOs to date, they have been constrained by certain aspects of the [NGO Law No. 84](#), which treats all NGOs equally, regardless of whether an NGO provides microcredit or not. The current financial management and audit standards, financial transaction approval processes, and administrative procedures required by the law are not suitable for microfinance institutions, which manage and administer large volumes of financial transactions. For example, regulations regarding signature endorsement for financial transactions may only be performed by a limited number of the NGO's officers. Given the large volume of financial transactions processed by microfinance NGOs on a daily basis, it is almost impossible to secure the signature of the NGO Treasurer as needed, especially when this post is filled by a volunteer. This needs to be changed to allow an employee (e.g. the Microfinance Activity Manager) to sign checks for loan issuance if increased access to financial services is sought.

Additionally, MFIs operating under the NGO Law face long, complicated, and time-consuming approval procedures to access capital, whether from donors or commercial banks. From

Egyptian banks' perspective, they refrain from providing non-collateralized loans to NGOs for the following reasons:

- 1) NGOs' decision-making cadres are made up of volunteers who have a limited degree of accountability in case of default.
- 2) Banks may face practical problems in foreclosing on NGO assets in case of default, in view of the status of NGOs as being under the supervision of the MSS.
- 3) Many NGOs lack sound governance structures.
- 4) NGOs often lack reliable and continuous cash flow.
- 5) The legal framework for NGOs is not suitable for undertaking credit and finance transactions.

All of these perceptions serve to limit access to capital and therefore restrain outreach and growth.

A solution to such problems would be for the NGO law to recognize and classify NGO-MFIs as a special type of NGO, and allow the establishment of financial management and auditing standards – as well as approval systems for accessing capital – that are suitable for microfinance operations. Allowing the existence of specialized credit NGOs would require a change in the law. In particular, the law should:

- (a) Recognize credit NGOs as a distinct type of NGO;
- (b) Require more active governance by NGO-MFI Boards than the level of governance that is currently exercised by most NGO Boards
- (c) Allow NGO-MFIs to pledge the assets that they possess (including active portfolio) for borrowings;
- (d) Allow NGO-MFIs to offer credit, seize collateral in case of default, and enforce loan contracts (collect bad loans);
- (e) Allow NGO-MFIs to access information from – as well as provide client credit data to – the recently established private-sector credit bureau (for NGOs extending loans larger than EGP 30,000); and
- (f) Exempt NGO-MFIs from certain current requirements governing NGOs with respect to their accounting and auditing, and grant them the right to receive funds and charge market-rate interest.

Furthermore, the problem of banks' difficulty in foreclosing on NGO assets may be addressed by coordination between the MSS, banks and NGOs that require access to capital, whereby the MSS issues a "commitment letter" to the financing bank/entity, promising not to foreclose on the NGO portfolio as long as the NGO-MFI is being financed by the bank/entity. This would

allow the NGO-MFIs to consider portfolio financing arrangements with banks, including leveraging/gearing.

For this to occur in practice, the SFD and various governmental and ministerial players would need to arrive at a consensus to distinguish NGO-MFIs from regular NGOs based on clear and objectively verifiable criteria. Accordingly, NGOs requiring access to capital should be assessed according to the established criteria and receive a quality assurance (QA) certificate, thus becoming certified as NGO-MFIs. The SRO should be the organization responsible for issuing and renewing certifications for NGO-MFIs.

6. Promote the Establishment of Non-Bank Commercial MFIs (Advocacy by EMFN)

Specialized MFIs such as cooperative banks, microfinance banks, and commercial credit-only institutions do not currently exist in Egypt. The existence of such service providers in the market could add greatly to the availability and outreach of a broad range of services. In the long term, the Microfinance Strategy vision of effective access by economically active poor and microentrepreneurs to a broad range of financial services will most likely not be achieved without the presence of a more varied range of financial service providers in the market.

With due regard for prudential safeguards that guarantee the integrity of the financial system and the safety of deposits, regulatory change should be considered to allow for the establishment of specialized financial institutions to serve microfinance markets in Egypt. At a minimum, the creation of *commercial credit-only financial institutions* should be considered in the Egyptian market. Such microfinance institutions would improve outreach and catalyze microcredit markets. This would require legislative reform that would determine whether they would be treated like banks or like NGOs for purposes of debt collection and foreclosure. Allowing these institutions eventually to take deposits could be considered; however, this would require that they be subject to prudential regulation. While this latter option is not an immediate priority, it is nevertheless one that should be considered in the longer term.

When regulatory change allows for the creation of non-bank commercial MFIs, successful NGOs may begin to consider revising their legal status to transform into formal financial institutions. This transformation option could appeal to NGO-MFIs that wish to offer a greater variety of services (e.g., savings, insurance, and remittances), thereby maximizing their outreach. Such transformations could significantly contribute to increased outreach and competition in the microfinance market.